The Weekly Market View

April 11 2016

بنك أبوظبي التجاري ADCB

Yen the biggest loser as ECB and BoJ careful to target currencies

Over the past month there seems to have been a ceasefire in the so-called global currency war in which central banks have tried to engineer a weaker currency in a bid to boost inflation. The strongest evidence for this ceasefire comes from the change in tactics by the European Central Bank (ECB) and the Bank of Japan (BoJ) in their last rate setting meetings in March. The ECB surprised the market with a larger than expected stimulus package, but importantly did so without targeting a weaker euro while the BoJ avoided any further action altogether, having seen the implementation of negative interest rates backfire earlier in the year. Perhaps the driver behind the ceasefire was either the realisation by the ECB and BoJ that trying to weaken their currencies in an environment with a more dovish Fed was futile, or the realisation that dollar strength (i.e. the flipside of euro and yen weakness) was exacerbating the commodity sell-off, hurting the Emerging world and putting the (still heavily dollar-linked) Chinese Renminbi in a very difficult position. Whichever the reason, targeted currency weakness by the G3 central banks appears to have stopped for now. However, with the yen having strengthened meaningfully of late, breaking below 110 to the dollar (108 at the time of writing, the strongest level since late 2014), there is a tangible risk that the ceasefire falters. Indeed the Japanese finance minister Taro Aso publicly stated that the 10% appreciation of the yen vs. the dollar this year was "undesirable" and that the government would take steps to counter "one-sided moves in currency markets". Needless to say, a resumption of the currency volatility among the G3 will likely lead to increased nervousness among investors, something to watch closely in the weeks and months ahead.

Wietse Nijenhuis
Equity Strategist
Tel: +971 (0)2 205 4923
wietse.nijenhuis@adcb.com

Rahmatullah Khan
Economist
Tel: +971 (0)2 696 2843
rahmatullah.khan@adcb.com

Luciano Jannelli, Ph.D., CFA
Head Investment Strategy
Tel: +971 (0)2 696 2340
luciano.jannelli@adcb.com

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Equities apprehensive ahead of earnings season

Equities struggled during the week, the Nikkei performing worst among the major equity markets for the reasons discussed above. Earnings season in the US kicks off on Monday with the expectation that the US earnings recession will continue. Consensus expectations are for a 8.1% y-o-y decline in S&P 500 company earnings. The US 10-year Treasury yield rallied to 1.72% during the week.

Past week global markets' performance

Index Snapshot (World Indices)

Index	Latest	Weekly Chg %	YTD %
S&P 500	2,047.6	-1.2	0.2
Dow Jones	17,577.0	-1.2	0.9
Nasdaq	4,850.7	-1.3	-3.1
DAX	9,622.3	-1.8	-10.4
Nikkei 225	15,821.5	-2.1	-16.9
FTSE 100	6,204.4	0.9	-0.6
Sensex	24,673.8	-2.4	-5.5
Hang Seng	20370.4	-0.6	-7.0
Regional Markets (Sunday to Thursday)			
ADX	4351.7	-0.9	1.0
DFM	3386.1	0.9	7.5
Tadawul	6258.1	0.6	-9.5
DSM	10164.8	-2.0	-2.5
MSM30	5609.7	2.6	3.8
BHSE	1117.3	-1.2	-8.1
KWSE	5230.4	0.0	-6.9
MSCI			
MSCI World	1,632.2	-0.5	-1.8
MSCI EM	816.8	-1.1	2.9

Global Commodities, Currencies and Rates

Commodity	Latest	Weekly Chg %	YTD %
ICE Brent USD/bbl	41.9	8.5	12.5
Nymex WTI USD/bbl	39.7	8.0	7.2
OPEC Baskt USD/bbl	34.7	0.5	11.0
Gold 100 oz USD/t oz	1240.7	1.5	16.9
Platinum USD/t oz	967.7	1.1	8.5
Copper USD/MT	4654.0	-4.6	-1.0
Alluminium	1506.5	-1.2	0.1
Currencies			
EUR	1.1399	0.1	4.9
GBP	1.4128	-0.7	-4.1
JPY	108.07	-3.2	11.2
CHF	0.9536	-0.5	5.1
Rates			
USD Libor 3m	0.6308	0.3	3.0
USD Libor 12m	1.2046	-0.7	2.3
UAE Eibor 3m	1.0256	0.9	-2.8
UAE Eibor 12m	1.5830	0.7	7.4
US 3m Bills	0.2238	0.0	37.6
US 10yr Treasury	1.7167	-3.0	-24.4

Please refer to the disclaimer at the end of this publication

Go back to start, do not pass go

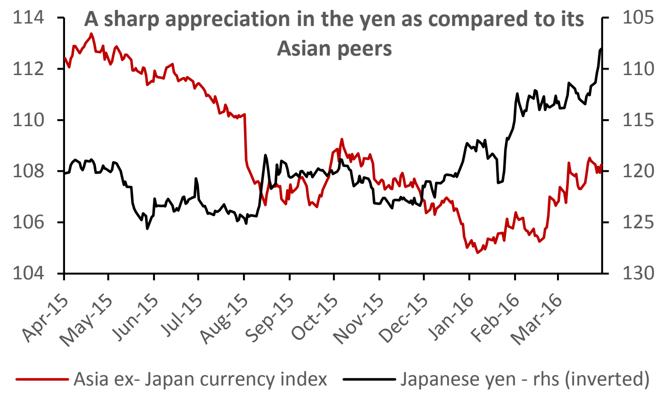
Implications of potential renewed BoJ intervention

Along with concerns over the viability of China's FX regime and concerns over the health of the global economy, one of the main contributing factors in the sell-off in risk assets at the start of the year was the ineffectiveness of central bank intervention, most specifically, ECB and BoJ intervention. The thinking was that if central bank policies are no longer successful in generating inflation, growth, or even a weaker exchange rate, that the global growth slowdown could not be cushioned any longer. These concerns faded during March as data improved and the so-called currency war (see page 1) among the world's major central banks ceased. The big worry now is that if dollar weakness goes too far, the BoJ and ECB will have no choice but to intervene again, potentially bringing us back to the same predicament as earlier in the year.

Global markets update

Global capital markets therefore are going through a very awkward transition. This transition is occurring at a moment that the global equities recovery rally of February-March (following the correction of January-February) appears to be petering out. It is important to bear in mind that - with the exception of US equities which we decided to overweight early January – most equity markets are still significantly below their January highs (indeed below the levels they had reached about a year ago / spring 2015). The recent recovery rally, however, has somehow been "contradicted" by the following developments:

- It has not come about together with a meaningful pick-up in Treasury yields (10 year Treasury yields were 2.3% early January, briefly reached a minimum of 1.66, but are now only at 1.72), in other words the stock-bond correlation somewhat broke down during the so-called recovery rally
- Year-to-date gold prices have jumped up to 20%, and they are still up 17% in spite increasing signals of subdued inflation and stocks recovering
- Emerging market currencies have surged against the US dollar on the back of renewed inflows into emerging equity and bond markets, yet the Japanese yen has appreciated against the US dollar even more than most emerging market currencies: in fact whilst more emerging markets recovered their early year losses (such that they are now more or less flattish) the JPY is up more than 10% against the greenback.

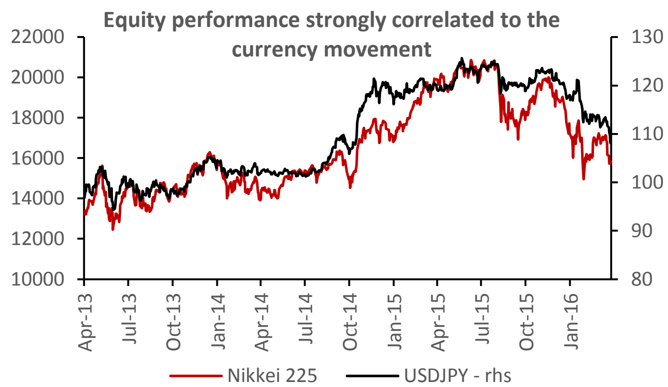


Source: Bloomberg

What does this really tell us?

It plainly tells us that the classical safe haven instruments – Treasuries, Gold, Japanese Yen – have not yet bought into the recent equity recovery rally. When investors buy an asset for risk-aversion reasons (i.e. out of fear of losing money elsewhere), yield is less important, in the limit it can be even negative.

Japan's listed companies are mostly exporters, thus they are seeing the domestic value of their foreign earnings depressed by the strong yen. This explains the persistently negative correlation between Japanese stocks and the JPY.



Source: Bloomberg

Equities a poor indicator of trouble ahead

Usually safe haven instruments – Treasuries, Gold, Japanese yen – are leading indicators of turmoil, whilst risky assets – such as equities – are, almost by definition, coincident or lagging indicators of turmoil. This should not be surprising given that the fundamental economic environment remains fragile, as now explicitly also recognized by the Fed, ECB and BoJ.

Conclusion

We stick to our equity underweight, and - within equities – we underweight all equity markets versus the US equity market (the "least risky" of all equity markets).

Summary market outlook

Bonds	
Global Yields	US Treasury 10yr yields eased a bit lower as the bond market continues to adjust to the smaller rate hike expectations from the Fed. We do not expect any sharp run-up in the yields in the short term, however, uptick is possible if economic data continues to surprise upside. European Periphery Sovereign yields tick-up a bit as ECB starts buying additional securities at the start of the month. However, these purchases will keep these yields contained.
Stress and Risk Indicators	The VIX index moved up as US equities corrected a bit. We have an upward bias for the index as global equities including US equities are unlikely to move much higher in the near term. Sovereign CDS Spreads, especially in the Asian EMs improved with the easing dollar strength. They could further improve in the very near term.

Equity Markets	
Local Equity Markets	GCC equities were mixed as oil prices witnessed a volatile week. The late last week rally in the oil price will provide positive sentiment to start with this week, markets will focus on the companies' quarterly result season as the week progresses.
Global Equity Markets	After a soft touch by Mrs. Yellen a week before, global equity markets are finding it difficult to move further up. Sharp gains in the prior weeks have made the markets vulnerable to some volatility in the near term.

Commodities	
Precious Metals	The decline in the risk sentiment last week pushed the gold price slightly higher. After the strong surge over the past weeks the precious metal is likely to be volatile and its moves will largely depend on how the risk sentiment remains over the next weeks. Longer term we see limited upside independently of temporary risk factors.
Energy	Decline in the weekly US oil inventories by almost 5 million and confirmation of the US oil production decline by another data supported the sentiment in the oil market which was also bolstered by the positive news flows on Doha talk for production freeze. However, we remain cautious in the near term given the volatility in the prices.
Industrial Metals	Industrial metals prices witnessed some correction last week after a sharp run-up in the prior weeks. We don't see any fundamental factors supporting industrial metals prices in the medium term.

Currencies								
EURUSD	The euro largely hovered around the current level within a relatively small range over the last week. The currency is close to its upper limit of the range (1.05-1.15) from where it is unlikely to move up in any significant way.							
Critical levels	R2	1.1520	R1	1.1460	S1	1.1333	S2	1.1266
GBPUSD	The cable gave up its prior week's gain over the last week as the "Brexit" issue continued to play a role. We believe that the currency pair will remain volatile, largely news-driven on the "Brexit" issue in the near term with a potential upward bias.							
Critical levels	R2	1.4468	R1	1.4298	S1	1.3982	S2	1.3836
USDJPY	Contrary to our expectations, the Japanese yen kept on getting stronger last week. This is not only the broader dollar easing but also seems to be that the market has started focusing on the diminishing effectiveness of the BoJ's policies. However, we continue to believe that the upside potential is limited in the currency, given the domestic economic outlook.							
Critical levels	R2	113.31	R1	110.69	S1	106.56	S2	105.05

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Forthcoming important economic data

United States

	Indicator	Period	Expected	Prior	Comments
4/13/2016	Retail Sales MoM	Mar	0.1%	-0.1%	Markets will focus on the retail sales and inflation numbers this week.
4/13/2016	Retail Sales Ex Auto MoM	Mar	0.4%	-0.1%	
4/13/2016	PPI Core YoY	Mar	1.3%	1.2%	
4/14/2016	CPI Core YoY	Mar	2.3%	2.3%	
4/15/2016	Industrial Production MoM	Mar	-0.1%	-0.5%	
4/15/2016	Univ. of Mich. Sentiment	Apr P	92.0	91.0	

Japan

	Indicator	Period	Expected	Prior	Comments
4/11/2016	Machine Orders MoM	Feb	-12.0%	15.0%	Machine orders and industrial production are likely to be focus of the market.
4/13/2016	PPI YoY	Mar	-3.5%	-3.4%	
4/15/2016	Industrial Production MoM	Feb F	--	-6.2%	
4/15/2016	Capacity Utilization MoM	Feb	--	2.6%	

Eurozone

	Indicator	Period	Expected	Prior	Comments
4/13/2016	Industrial Production MoM	Feb	-0.7%	2.1%	Unemployment rate, PMI services and retail sales will be looked at by the market.
4/14/2016	CPI YoY	Mar	1.2%	0.2%	
4/14/2016	CPI Core YoY	Mar F	1.0%	1.0%	
4/15/2016	Trade Balance	Feb	€21.5B	€21.2B	

China and India

	Indicators	Period	Expected	Prior	Comments
This Week	New Yuan Loans (CH)	Mar	1025B	726B	A large set of data from China and India, especially Chinese first quarter GDP growth to be market's focus.
This Week	Money Supply M2 YoY (CH)	Mar	13.5%	13.3%	
4/11/2016	CPI YoY (CH)	Mar	2.4%	2.3%	
4/13/2016	Exports YoY (CH)	Mar	10%	-25.4%	
4/13/2016	Imports YoY (CH)	Mar	-10.1%	-13.8%	
4/15/2016	Industrial Production YTD YoY (CH)	Mar	5.5%	5.4%	
4/15/2016	Retail Sales YTD YoY (CH)	Mar	10.2%	10.2%	
4/15/2016	Fixed Assets Investment YoY (CH)	Mar	10.4%	10.2%	
4/15/2016	GDP YoY (CH)	1Q	6.7%	6.8%	
04/12/2016	CPI YoY (IN)	Mar	5%	5.2%	
04/12/2016	Industrial Production YoY (IN)	Feb	1%	-1.5%	
This Week	Trade Balance (IN)	Mar	-$6.9B	-$6.5B	
This Week	Exports YoY (IN)	Mar	--	-5.0%	
This Week	Imports YoY (IN)	Mar	--	-5.7%	

Sources

All information in this report has been obtained from the following sources except where indicated otherwise:

1. Bloomberg
2. Wall Street Journal
3. RTTNews
4. Reuters
5. Gulfbase
6. Zawya

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